

penetrated the Japanese market successfully and have built their own dealership networks there. We could do the same.

The Clinton administration could announce such developments as trade goodies its bluster has won, while taking the more intractable issues to the WTO for arbitration. The Japanese government would certainly play along. Its leaders know that saving face is as important in the Occident as in the Orient.

When the dust has settled on this latest skirmish, we should draw back and ask: Does it make sense to conduct trade diplomacy with Japan in such *High Noon* fashion? Surely it is time to normalize our dealings with Japan: seeking bilateral resolution of our (and their) complaints, and turning to the WTO for rulings when we cannot agree among ourselves.

Japan has changed irrevocably. The new generation, many of its members trained in our universities and as independent-minded as we are, will no longer accept our highhanded ways and one-sided demands. The Clinton warriors are discovering, painfully, that they are not fighting samurai anymore, but other GIs.

21

The U.S.-Japan Car Dispute: A Monumental Mistake

In Washington, U.S. trade policy is often asserted by official spokesmen, and accepted widely by the media and (I am sorry to say) by several economists who are unfamiliar with the issues and are bamboozled by the rhetoric, as one of President Clinton's success stories. In reality, when one probes deeper and looks for necessary nuances, it is almost a disaster area.

The popular approbation derives, of course, from the fact that President Clinton saw the Uruguay Round and NAFTA through a divided Congress and opposition within his own party. This was a welcome development for many supporters of free trade who had been deeply concerned by the president's initial ambivalence on the matter, whether due to lack of conviction or divisions among his political advisers. In fact, I was sufficiently distressed by the initial presidential fence-sitting on trade to remark in an afterdinner speech that, while the problem with President Bush had been that one could not read his lips, the problem with President Clinton was deeper: one did not know whether to read his lower lip or his upper lip.

But if President Clinton deserves applause for finding his convictions on freer trade over the Uruguay Round and over NAFTA, the same cannot be said of his administration's actions in regard

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to the principles of multilateralism. In particular, the administration's record can be faulted on (1) the use of aggressive unilateralism, in the form of unilateral threats of tariff retaliation illegal under the GATT; (2) its willingness to demand "managed trade" in the shape of import targets or what I called, and now others also call, VIEs (voluntary import expansions) from Japan; and (3) its obsession with the extension of preferential trade arrangements (PTAs) under GATT Article twenty-four, even when the GATT has been jump-started and its successor, the WTO, is in forward gear.

I have dealt extensively with the last issue in several recent writings; and many economists have now come to raise objections to the Clinton administration's desire to "walk on both legs" and to suggest that we may instead wind up "walking on all fours" if we enter into both MTN (multilateral trade negotiations) and PTAs instead of reverting to exclusive reliance on MTN under WTO auspices.¹ In this article, however, I plan to examine the U.S.-Japan car dispute as a prime example of what has been wrong with U.S. policy in relation to the two issues mentioned above: aggressive unilateralism, and demands for managed trade in the form of VIEs and their virtual equivalents.

The General Background

The Clinton administration took office on the basis of a campaign among the elements of which were an obsession with Japan's trade surplus and its trade practices and a declaration of intent to revive the lapsed Super 301 provision of the 1988 Omnibus Trade and Competitiveness Act so as to bring Japan to book for its wittingly wayward presence in the world economy. The major figures on whom the administration relied in its early days for advice in these matters were the well-known former bureaucrat Clyde Prestowitz, scarred by battles with the Japanese over years

of trade negotiations and a Republican who threw his support behind Clinton as presidential candidate on these issues, to the latter's great delight and gratitude; the noted journalist James Fallows, whose splendid early judgment that the best U.S. response to the rise of Japan and the Far East was to be "more like us" (that is, to accentuate reliance on what was best in the U.S. system rather than to imitate the alleged Japanese virtues) had yielded to frantic demands to "contain Japan" after he had spent a year there (whereas familiarity is said to breed contempt, in the case of Japan it often seems to breed panic); and the articulate and influential columnist Robert Kuttner, a new Suslov in the Democratic Party and founding editor of the *American Prospect*, about whom a Washington wit had remarked that "Kuttner had not yet met a tariff that he did not like."

The main economists chosen by the Clinton administration were also known to be sympathetic to these views: the current deputy secretary of the Treasury, Lawrence Summers, an economist of great ability, had expressed hawkish views on Japan's trade policy and alarmist views on the consequences of Japan's trade surplus; and the choice of Laura Tyson as the chairwoman of the Council of Economic Advisers, to the chagrin of others who aspired to the job, was evidently inspired by her sympathetic views on industrial policy and the Super 301 provisions, and by her clear declaration of support for an aggressive policy toward Japan on high-tech industries in her 1992 book *Who's Bashing Whom? Trade Conflict in High-Technology Industries*, published with superb timing and with dividends for the author.²

Mickey Kantor's appointment as the U.S. trade representative (USTR), succeeding Carla Hills, also turned out to be a major shot across the bows in the new era of confrontation with Japan and aggressive pursuit of U.S. trade demands. In a characteristic statement, he announced early on that he had no time for "theology" and that he would instead go for "results": in short, he was a

litigator out to win a case, with no interest in jurisprudence. Free trade and multilateralism were not the issue; the goal was to advance U.S. trade interests. He proudly claimed that he talked to Prestowitz on Japan; no reputable scholars on international trade generally or on Japan's trade in particular appear to have had the benefit of sharing their views with Mr. Kantor.

If there was any prospect of dissent, it yielded to the fierce loyalty that the new trade policy toward Japan seems to have required within the administration. High officials who had been moderate and "cosmopolitan" on Japan opted for silence and prudently gave ground. The effect of the aggressive tactics on the influential outside critics too, may have been chilling. Fred Bergsten, head of the Institute for International Economics in Washington, long unfairly attacked by James Fallows and Pat Choate (the author of the anti-Japan screed, *Agents of Influence*) as being soft on Japan because of Japanese financial support for his institute, now found Super 301 revival a good idea and also changed his mind in the administration's direction on how closed Japan's markets were: changes that were presumably prompted by more reflection but were certainly welcome to the new administration.

The new, tough policy on Japan was not entirely new, of course, since elements of it can be found in the Bush administration as well. But the Bush administration had been opposed to the tough versions of the 301 provisions in the 1988 Trade Act. The use of Super 301 against Japan represented a surrender to strong congressional pressures, given the fact that the 1988 act had landed the Bush administration with a very difficult situation vis-à-vis Congress; but it was effectively undercut in several ways by the USTR. Similarly, the Bush administration's use of import targets was minimal: the numbers cited in the Tokyo communiqué on the purchase of U.S. parts by Japan's automakers, for example, were clearly not meant to be firm targets.

The Clinton administration, by contrast, wanted to revive the lapsed Super 301, wished to elevate indicative numbers in some cases to a firm principle of managed trade with Japan more broadly, and saw the confrontation with Japan as a necessary shift of gear in trading with that country. It was ideologically dressed in the garb of what has been called *realeconomic*, a concept propagated by those such as Ed Luttwak who contend that economic rivalry is important "now that the cold war has ended" (a school of lazy minds that mechanically asserts that everything must change because the cold war has ended) and by others who argue that trade is a zero-sum game (a notion that the economist Paul Krugman now derides but himself encouraged in the 1980s by a careless translation of the principles of trade policy under imperfect competition into public discourse).³

The shift in policy toward Japan that the Clinton administration wished to execute was based on the following premises:

1. Japan was unfairly closed while the United States was open, giving Japan's firms considerable competitive advantage vis-à-vis U.S. firms.
2. This assessment could be made unilaterally by the United States and did not have to be validated by impartial procedures.
3. The closure of the Japanese markets was "informal" and hence the remedy for it was to ask Japan to accept a "results-oriented" VIE or "managed trade" approach to its imports.
4. The way to get Japan to accept such an approach was to use 301-sanctioned tariff-retaliatory threats against Japan, even if these were illegal under the terms of the GATT.

These premises, however, were either based on faulty economic analysis or politically unrealistic. With regard to the first premise, the view that Japan is so asymmetrically closed that it is an outlier, wildly off the curve, in its exclusionary import policies or

situation, is far from generally agreed among economists. The Clinton administration's simplistic reliance on indicators such as Japan's lower share of imports in GNP vis-à-vis the OECD average, a bad habit they picked up from a fortunately minuscule but much-cited group of Japan-obsessed economists such as Rudiger Dornbusch (MIT) who rely wholly on such sloppy arguments, can be easily countered by noting that the fact that Canada has a vastly greater share of imports in GNP than the United States does not make Canada a vastly more open economy! As it happens, over a dozen econometric studies by different economists, put together by the Japan scholar Gary Saxonhouse at Michigan, have examined the question much more subtly and concluded that it is hard to characterize Japan's import share as "too low."

The second premise is neither good for the world trading system nor politically sensible. It is bad for the trading system because every such complaint should be assessed by impartial authorities rather than by the country making the complaint: the alternative to such a rule of law is subservience to the law of the jungle. Indeed, the office of the USTR is so captive to lobbying interests, as against the general interest, and its famous annual report on unfair trading practices abroad is so much a farrago of uncensored, unexamined industry complaints and assertions, that it is hard to credit the U.S. methods with any degree of legitimacy or credibility. Such unilateralism has been received by the world community with as much approbation as vigilantes, who seek to take the law into their own hands, receive from thoughtful citizens.

As for the third premise, the notion that a unilateral determination of Japanese "informal barriers," regarded as revealed in "too low" imports, should be fixed by setting VIE targets, flies in the face of the fact that only markets can determine what appropriate market shares and imports will be. No bureaucrat or economist can determine what the market will or will not do; in fact,

arrogance in assuming that one could was the source of the massive inefficiencies that characterized planned economies such as India and the Soviet Union. The only valid procedure is to identify the alleged barriers and then to address them directly. It is also the case that, given this inherent impossibility of bureaucratically predetermining market shares, VIEs will turn into "export protectionism": export lobbies will use VIEs to carve out guaranteed shares in export markets in just the way that VERs and import quotas, constituting "import protectionism," seek to carve out guaranteed shares in the domestic markets.⁴

The fourth and final premise that Japan will succumb to unilateral threats is politically unrealistic. As I argued in an article entitled "Samurais No More" in the May-June 1994 issue of *Foreign Affairs* right after the failure of the Hosokawa-Clinton summit in Washington in February 1994 when Prime Minister Hosokawa refused to accept VIEs despite the threat of retaliatory retribution (much as Prime Minister Miyazawa had indicated in an earlier, friendlier summit), the Clinton warriors thought they were fighting the samurai when in fact they were fighting GIs. The Japanese have been changing rapidly: their students, now in the United States in vastly increased numbers, no longer bow before the revered *sensei* but put their feet on the table like the American students; and the women and children living abroad with the executives who populate the increased numbers of Japanese multinationals in the EU and the United States are agents of quick and powerful change. Once paralysed at the red and amber traffic lights by their traditional discipline, the Japanese can now be seen crossing against the light. These are no longer patsies who can be pushed around with trade demands justified by unilateral, lobby-led accusations. Yes, they will make even difficult trade concessions within reciprocal frameworks such as MTN at Geneva; but the notion that the Japanese can continue to be intimidated into making one-way trade concessions when the standard game

is for such concessions to be made with some reciprocity—I give you some and you give me some—is to ignore the compelling reality that those days are past.

What is astonishing is that the Clinton administration, which had been badly chastened by the stubborn refusal of the Japanese government to cave in to the demands for managed trade and the attendant failure of the Hosokawa-Clinton summit, and whose policy toward Japan had become better informed and more mindful of the damage inflicted on the United States by earlier demands for managed trade, suddenly gave way in the dramatic dispute over cars. The reappearance at centre stage of a policy that had been discredited and discarded must be explained; and its consequences for the multilateral world trading system must be examined. As I argue below, the revival failed miserably, as was to be expected; but there is no assurance that the Clinton administration will not try again; indeed, the rhetoric of success in the car talks is so assiduously spread by the administration, and believed by so many, that it may well work itself into a misperception of a true victory rather than an ignominious defeat for which the true supporters of the multilateral trading system can only be thankful to the successful Japanese negotiators.

Explaining the U.S. Action

The central fact was that the United States explosively elevated its car dispute with Japan to centre stage with the unilateral declaration of 100 percent punitive tariffs on thirteen models of Japanese luxury cars if the Japanese negotiators did not capitulate on demands for “voluntary” import expansion (VIE) targets. Interestingly, while the rest of the world (especially the EU spokesmen such as Sir Leon Brittan) predictably voiced their outrage and their criticisms of this move, Mr. Kantor, with characteristic delicacy of language, proclaimed that his critics could “scream,

like pigs stuck on a gate” for all he cared. The crude analogy was more apt than he thought: pork was indeed a prime mover behind the action that he announced, flanked by the commerce secretary (Ron Brown) and the National Economic Council chairwoman (Laura Tyson).

An action that predictably destroyed the credibility of the administration's respect for the rule of law and its commitment to multilateralism, and brought the United States into disrepute and disgrace,⁵ could only have been taken under a unique conjunction of several factors, all pulling in the same direction and all leading the United States down the low road. These factors were both political and bureaucratic; and they were translated into action because the economics of the car industry, both in Japan and in Detroit, combined with the rise of the yen to make the “managed trade” demands for VIEs (and other numerical targets such as those on dealerships), backed by aggressive unilateralism in the shape of punitive tariffs on Japan's car manufacturers, an irresistible proposition to the administration's strategists. Let me explain.

The Political Factors

The political aspect of the revived policy is manifest. President Clinton's political advisers saw great advantage in targeting the Japanese car industry. Representatives Gephardt (D-Missouri) and Bonior (D-Detroit), powerful foes of the administration over NAFTA, represent constituencies where the car industry is important. At the same time, the trade unions, while now representing under 12 percent of the private labour force, are nonetheless an important Democratic constituency, with the UAW an important player. Furthermore, with Mexico's bailout having revived the politics of NAFTA, and the illogical but influential “I-told-you-so” charges leveled by Ross Perot and the unions, the administration clearly hoped to deflect the antitrade sentiment to the perennial

Japan-baiting arena. Indeed, the president unabashedly used anti-Japanese sentiment to sell NAFTA: the United States would have privileged access to Mexico's market, whereas Japan would not.

The ceaseless repetition by the administration—and by some influential columnists who have become de facto unofficial spokesmen for the USTR—of the assertion that Japan is “closed,” in blatant disregard of the widely shared huge scepticism in respect of this claim among major Japan scholars in the United States,⁶ had continued to poison the domestic atmosphere in favour of ceaseless one-way demands on the Japanese, as in the car negotiations. Ironically, the United States has protected its own cars, having imposed voluntary export restraints (VERs), now virtually outlawed by the WTO, on Japanese exports in May 1981 and continued them de facto until recently. Of course, you never hear about them when Mr. Kantor takes to the hustings.

The result is that it is impossible for elected U.S. politicians to attack the administration's demands on Japan without appearing to be condoning Japan's “closed markets,” as was evident in the nearly unanimous nonbinding resolution that was passed quickly in the Senate in support of the administration's policy.

The Bureaucratic Factors

The politics of pork was not the sole driving force behind the Clinton administration's action. Bureaucratic interests were equally important. Commerce Secretary Brown's enthusiastic and visible support for the action is to be explained in part by his and his department's predicament: he was under a cloud and his department was threatened with extinction by the Republican Congress. Manifestly, “opening markets” is a slogan and a goal whose appeal no politician could discount in a town where there are two overriding principles of trade policy: imports are bad; and exports are good. Piggybacking Mr. Kantor on the anti-Japan

offensive gave him cachet and his department the rationale for survival; and it correspondingly gave the anti-Japan policy extra clout and support.

In addition, the question of petty bureaucratic pride must not be forgotten. When the Hosokawa-Clinton summit collapsed, as some of us had predicted it would, so did the reputation of the proponents of the new hard line toward Japan, premised on the fallacy that aggressive unilateralism and demands for VIEs are desirable policy instruments. Evidently, these proponents had taken the president down the wrong path. It was not great for them, no matter what excuses they offered up, to have such a failure on their record! There is little doubt that they were sulking, waiting, looking for an opportunity to outwit and waylay Japan so that the principle of VIEs would be conceded, and that too in the context of the use of the Section 301 variety of aggressive unilateralism. Roger Altman (the former deputy secretary of the Treasury) had threatened that he would wait “until hell freezes over” for Japan to yield to U.S. demands—unfortunately, he himself could not as the U.S. Congress had different plans for him⁷—and this was certainly the sentiment and aspiration of all bureaucrats of his ilk: one day, some time, some way, we would “get them.”

Opportunity finally presented itself in the case of the car industry, offering these discredited bureaucrats a chance to push again for the failed policy, de facto abandoned in 1994 and 1995 and, in fact, certified to be so by Thomas Friedman of the *New York Times*, a vigorous critic of Japan.⁸ Vindication was finally at hand.

The Irresistible Opportunity

It is easy to think that the car industry was the natural choice for the recent U.S. action. After all, it was the last of the sectors under

the Framework Agreement. Perhaps the office of the USTR and its allies thought that the Japanese government might accede to demands for VIEs, under 301 tariff threats, as a way of getting the last remaining dispute out of the way and then settling down to a normalized trade relationship. If so, they did not, of course, understand that there was little reason for the Japanese government to expect that this would indeed be the "end game." Just look at the USTR's annual report on the unfair trade practices of others and the litany of complaints against Japan by several industries: would it really be reasonable for the Japanese trade ministry, MITI, to think that demands for VIEs, under threat of 301 tariffs, would disappear, instead of spreading to these numerous other industries, especially after the car industry's success? In fact, if MITI had any doubts, they should have been squashed by CEO George Fisher's firing of his own Eastman Kodak salvo against the Japanese soon after Kantor's action for the car industry.

The more reasonable assumption has to be that Kantor's clear expectation was that the car negotiation would end with Japanese acceptance of VIEs (and other demands), and that he expected this to be beneficial, not just for the political and bureaucratic reasons noted above, but also because it would establish the precedent with Japan that VIEs were the way to gain access to the Japanese market for several more industries.

The question to be answered, then, is, Why was the car industry chosen for Kantor's blitzkrieg? That negotiations were already under way in the car industry is hardly a sufficient reason. The answer has to be that the car industry offered the best prospect of winning the war that Kantor would declare. And, on reflection, it is obvious that the car industry offered him the best prospect for success, especially as, learning from the failure of the Hosokawa-Clinton summit, he had brilliantly shifted from seeking the VIEs

from a Japanese ministry and *government* that had learnt to say no (to VIEs) to forcing the Japanese car *firms* instead to capitulate to these demands, while MITI minister Hashimoto would be left on the sidelines, wringing his hands.

The high yen had already increased the incentive for Japan to shift to imports of more components for new cars and of "aftermarket" replacement parts, quite regardless of any VIE commitments; under these circumstances, the U.S. demand that the Japanese car firms accept VIEs for increased imports of components was not exactly the imposition that it would otherwise have been (although, of course, the firms were also being asked to accept other loss-causing obligations, such as letting their Detroit competitors have numerically guaranteed access to their own single-agency dealers in which they had invested over the years). However, while the cost of *compliance* with the USTR demands was not particularly exorbitant, thanks to the high yen, the USTR strategy was to make the cost of *noncompliance* with the demands extremely high, thus making the prospect of capitulation by the Japanese car firms appear inevitable. The high yen had already put the Japanese car firms under serious strain. Why not impose huge financial penalties on them for noncompliance? The obvious way to do this was to levy punitive tariffs on their successful exports: in essence, hit them hard so that they hurt bad. Hence, the tariff retaliation was aimed at the car industry itself, violating the GATT injunction not to raise the bound tariffs and therefore making the action manifestly illegal under the GATT (if and when the tariffs were actually levied).⁹

Clearly, the strategy was to intimidate the Japanese car firms into capitulation as quickly as possible under threat of financial sanctions. This also explains the decision to make the tariffs retroactively effective almost immediately after the announcement of the intention to levy them, even though they would be imposed

only in late June (if at all): this was calculated to increase the pressure on the firms to settle forthwith. The refusal to let the fast-track procedure operate on Japan's suit against the 301 action at the WTO was also similarly motivated and violated the spirit of the Uruguay Round accord since the fast-track procedure was taken from the earlier GATT practice on perishable agricultural products where delay would be costly and unjust to the targeted nations: the same principle clearly should have applied in this case, for the Japanese car firms that were targeted would suffer market disruption because of the backdating of the potential levy of the illegal retaliatory car tariffs.¹⁰

The tactical shift to making the car firms, rather than the Japanese government, the target of the punitive tariffs was a brilliant move in the sense that the evil genius Lex Luthor's moves are brilliant in the *Superman* movies. It pitted the full power of a sovereign government, and a superpower to boot, against private foreign firms operating under strict hard budget constraints. It was an inherently unequal contest. But, as I argue more fully below, this was not a move that could escape the attention of the government of Japan whose private firms were thus being intimidated and whose general trading interests would be directly jeopardized if this outrageous action were allowed to succeed and to set a precedent. Nor could economists who are interested in the design of an appropriate world trading system, as distinct from the successful pursuit of narrow and self-serving interests by myopic bureaucrats and politicians, be indifferent to what the USTR and the Clinton administration had done.

The Role of Detroit

I must also explain why the Detroit car firms lobbied for this set of demands and actions, instead of getting into the open Japanese

car market as the European car firms have done, successfully and without using any such tactics. For, even though it has become customary in the United States to dismiss Japan's repeated claims that its car market is open, the fact remains that it is. Indeed, the executives of several European car firms have frankly said so, and many economists who have looked at the subject agree.

While I detail below the reasons why the Detroit car lobby's demands, taken over uncritically by the USTR,¹¹ were based predominantly on unsupportable complaints about the Japanese car market, let me state immediately that these demands made ample economic sense from Detroit's viewpoint, lending therefore further salience to a policy that reflected the compelling political and bureaucratic factors detailed above. The facts are that Japan's car market is expensive to enter and the sales prospects are unexciting, thus making it a considerably less attractive market to put one's marketing and other resources into than those of developing countries such as China, India, Indonesia, etc. (which the erstwhile under secretary for commerce, Jeffrey Garten, called the "emerging markets" around the world). If you sell cars in Japan, you *are* free to open up your own distribution system, advertise, cajole, and seduce your customers. But, in an advanced country, the costs of setting up such a distribution system of your own dealers are going to be hugely higher than in India and China, for instance. Of course, if you can use politics to piggyback on someone else's distribution system, you can cut down that cost of entry substantially. Hence the demands for such a "multiple-agency" system to be forced, with targets, upon Japan's car manufacturers: a demand that these firms have generally resisted much as the Detroit transplants in the European Union have strongly resisted such demands there. Then again, the market-determined sales-growth curve in Japan cannot be expected to be even fractionally as promising, whether for finished cars or for components, as

virtually anywhere else. After all, you would be competing with the world's most formidable car manufacturers on their home ground. Hence, it would be a great help if the USTR could guarantee robustly growing sales through VIEs and such numerical targets.

These economic fundamentals, then, immediately defined the economic underpinnings of Detroit's demands, while the bureaucratic and political factors defined the reasons why these demands came to be embodied in the current policy.

The U.S. Demands: Ill-Conceived Stipulations Based on Dubious Complaints

It is not surprising, therefore, that nearly all of the Clinton administration's complaints were dubious at best; its demands, whether on the after-sales parts market or the sales of new cars or the purchase of components and parts for car manufacture, were therefore ill-conceived and inconsistent with the spirit of the WTO. Let me indicate why.

"Aftermarket" Replacement Parts

The United States complained that Japan required excessive car inspections, every two years, going well beyond what is necessary for safety in the U.S. judgement, and also that Japanese car manufacturers had captured the inspection stations which then did not carry U.S.-made spare parts. The U.S. objection to the inspection system is about as sensible as Japan telling the United States that American torts liability rules impose excessive burdens, including some on Japanese businesses in the United States, and therefore ought to be changed. The American public properly expects Congress, not MITI or Mitsubishi, to be concerned with that agenda.

The United States also wanted the garages to carry U.S.-made parts, though it is hard to see how the inventory policy of private businesses can be effectively prescribed by any government. The obvious and efficient solution is rather to set up U.S.-owned garages, carrying U.S.-made parts, and to ensure that these garages are readily certified for inspection (which, if denied, would be quickly adjudged to be an effective barrier to U.S. entry and therefore an excellent case to win before the WTO). But that would mean making the investment necessary to capture this market, which is where the real difficulty lay.

Access to Dealerships

The administration insisted that the Japanese car dealers, affiliated to specific Japanese firms, carry U.S. cars as well. Nothing prevents the U.S. firms from setting up their own single-agency distribution systems, as they used to, and as the Europeans continue to do (having only just renewed the exemption from the European directive on competition policy for the car industry, with American transplant car firms in Europe in tune with that decision, of course). Admittedly, if Nissan and Toyota were to hire someone to break the legs of those who work for U.S. dealerships, that would be a legitimate reason to allege barrier to American entry. But they do not. And other entrants, such as BMW, have indeed made the investments necessary to set up their own dealers.¹²

Chrysler spokesmen's familiar complaint that they would have to buy land at exorbitant prices while the Japanese firms bought their land at low prices makes as much sense as Governor Clinton's telling Mayor Koch that free trade between Little Rock and New York is unfairly stacked against the former because rents are exorbitantly higher in New York. Besides, an accountant would lose her licence if she allowed Japanese firms to continue costing their

land at historic, rather than market, prices. Shall we hear next that, because Toyota, for the same reason, manages to produce more cheaply in Japan than U.S. firms entering the market could today, its production facilities in Toyota City should be opened up to produce U.S. cars?

Parts in New Cars

The administration also demanded that the Japanese car manufacturers set up "voluntary purchase plans" for expanded purchases of U.S.-made components. The United States has already coerced the Japanese transplants in the United States into buying more U.S.-made components, while inconsistently lecturing other countries for doing the same more formally and also building into the WTO prohibitions against "local content" requirements. Now, the United States was saying: if you can buy U.S.-made parts for your cars in the United States, why not for cars made in Japan? In short, the United States used one forced enhancement of sales of U.S.-made parts to justify another!

Never did the United States confront the critical issue, namely: if *keiretsu* are barriers to entry, what do we do about vertical integration which we have conventionally preferred? In fact, it is easier to maintain that the *keiretsu* by relying usually on multiple and changing suppliers, are easier for outsiders to crack than vertically integrated firms (such as IBM making and "buying" its own chips and General Motors buying nearly 75 percent of its parts from within).¹³ Again, if markets are contestable, as they certainly are in the outside world—and, in my view, within Japan too; but this is not essential to my argument in an industry where markets are global—no Japanese firm can afford to buy from its favoured Japanese suppliers to the exclusion of more efficient foreign suppliers without being mown down in a tough, competitive environment.¹⁴

Publicizing the Case: The Los Angeles Lawyer Syndrome

Needless to say, the American public did not hear the truth of these matters. Instead, it got a barrage of half-truths and obfuscations, delivered with a calculated and cynical flourish to the media to gain propaganda advantage and to mislead the country into support of a disgraceful policy.

Since Mr. Kantor was the flamboyant star of this show, it is helpful to recall that he is not merely an American lawyer; he is also a Los Angeles lawyer. For those who watched the O. J. Simpson trial, Mr. Kantor seems far less of an original than he appears to the untutored eye.

Aside from his continual banter, he threw in the occasional red herring. To justify his actions, he argued also that history owed Detroit an apology and Japanese acceptance of the U.S. demands. This "down payment" was necessary because "through high tariffs, allocations of capital, and a range of other measures, the government of Japan in essence kicked foreign producers out of the market."¹⁵ Quite aside from the inaccuracy of this claim, surely Kantor did not plan to make history a handmaiden for his claims on other nations. If so, the United States owes Britain a hefty down payment since the United Kingdom was a unilateral free trader through the decades in the latter half of the nineteenth century when the United States was protectionist. Indeed, consider that, having not afforded intellectual property protection to others when it was behind on innovation during its early history, the United States is happy to accuse others, now that it is among the innovators, of theft and piracy. Should it not instead, according to the new Kantor doctrine of contrition for one's past, offer "down payment" to the world for its earlier bad behaviour?

Mr. Kantor's lawyerly expertise was best seen, however, not in the specious arguments which he concocted with the utmost apparent sincerity, but rather in the suit that he declared he was

bringing against Japan at the WTO for nullification and impairment of its trade concessions and of America's corresponding rights in the car industry. In fact, such a suit, under Article 23(I)(b) or perhaps 23(I)(c), targeted at narrowly and carefully specified Japanese practices that were considered to be pertinent, had been proposed as the correct course of action by many for some time. The long-standing decision not to mount such a suit had been a result of objections from two sources: first, from those who thought the United States would lose (and so, presumably it would be better to browbeat the Japanese into submission through aggressive unilateralism instead; after all, the United States "knew" they were guilty of nullification and impairment, even though it could not prove it at the WTO); and second, those who thought the United States would win (in which case the law so made could come back to haunt the United States as well).

The change of mind about an Article 23 suit certainly had nothing to do with a change of mind on the matter at issue. Rather, the suit had every mark of being what American lawyers call a "countersuit." If I take you to court on something wicked that you have done to me, your lawyer will usually advise you to start a suit against me, for bargaining purposes. Kantor's proposed suit against Japan was clearly such a countersuit. It had the advantage of tying up the Japanese in a defensive mode just as they were preparing themselves for their own, far more compelling, suit against the proposed U.S. punitive tariffs, illegal under the WTO. But that is not all. It also could be expected to blunt, in the uninformed public eye, the criticism that the punitive actions against Japan were unilateral and illegal under the WTO by suggesting that the United States was going to the WTO and seeking multilateral remedies for its complaints. In short, it was an effective diversionary tactic: in fact, if the United States did mean to take the multilateral route to getting its complaint adjudicated, it would have had no reason to press ahead with the illegal and

aggressive unilateralism. Indeed, since the game plan was to get the Japanese car firms to capitulate quickly, so that the Japanese suit and the U.S. countersuit would become moot, the U.S. strategists had clearly gambled that they would not have to face the consequences of actually confronting Japan in litigation at the WTO. These consequences were not pleasant to contemplate; hence, the bluster got louder as the deadline for the threatened imposition of punitive tariffs came closer, just as it did during the Hosokawa-Clinton summit.

In the end, the U.S. strategy failed: the Japanese, as should have been expected by informed analysts, yielded nothing of consequence, explicitly rejecting (for the first time) VIEs in any form. The U.S. threat to use punitive tariffs illegal under the WTO had simply not been credible: the WTO would have found against the United States some time during the election year, badly exposing President Clinton to the charge, not that he was wrong to stand up against Japan (that is politically a nonstarter), but that his chosen method of doing so had been incompetent and had hurt the United States instead.

In particular, the notion that the car firms in Japan would capitulate under financial pressure, forcing capitulation in turn by MITI, turned out to be wrong. MITI could surely not be expected to stand by while the car firms caved in: the consequences for Japan's trade would be too dramatic, reaching well beyond the car industry itself, for MITI to stand idly by. An obvious answer therefore, which I sketched in an op-ed piece in May 1995 in the *Journal of Commerce*, was for MITI to provide financial subsidy to the car firms to offset the punitive tariffs. There is evidence that this was actually done, using the R&D subsidy provisions of the Uruguay Round Subsidies Code to make the support compatible with WTO rules. Moreover, the U.S. strategists did not allow for the fact that Mr. Toyoda, chairman of Toyota, was also the president of Keidanren that year and was reported to feel that, while

his car firm would find it easier to capitulate than to fight, he owed it to Japanese industry in general, in his presidential capacity, to fight instead. Suffice it to say that the U.S. strategists were oblivious to these complexities, were ignoring the lessons of the failed Hosokawa-Clinton summit, and continued to be generally unmindful of the new Japan with which they were dealing. Their failure came as no surprise to me. Nor did the fact that Mr. Kantor, true to form, declared victory and Mr. Hashimoto's political stock rose in Japan, where propaganda had not obscured the true facts of the car accord reached in Geneva.

The Consequences of the U.S. Action

The consequences of the U.S. action in the car dispute are certain to be contrary to the benign ones clearly assumed, and even asserted, despite the failure of the U.S. strategists.

Damage to the World Trading System

(1) The 301 action (even though the threat of punitive tariffs was withdrawn on June 28, 1996) has already damaged the cause of multilateralism. The general assumption at the end of the Uruguay Round was that the United States had renounced unilateralism and would abide by the rule of law at the WTO. This assumption was laid waste by Mr. Kantor, creating bitterness in Geneva and cynicism among members of the WTO.

The assertion that no action illegal under the WTO actually took place, because the threat of punitive tariffs was not actually translated into their imposition on June 28, is strictly correct. But this is a technicality; and the assertion that the United States would in fact go ahead and undertake such illegal action unless its demands were met is certainly an indication of the U.S. willingness to flout WTO rules to its advantage.

In fact, given the U.S. willingness to use unilateral threats against WTO members under the technical protection that only actual violations of the WTO are illegal, it is time to consider whether this distinction should not itself be outlawed. In international relations, the presence of a sufficiently credible threat is itself treated as justification for preemptive response. It should be treated thus in the 301 type of threats: perhaps a WTO dispute settlement panel will in future make such a finding at a suitable opportunity, putting the U.S. practice of making such a self-serving distinction out of bounds.

(2) Damage to the WTO also derives from the fact that the U.S. action put the credibility of the new institution in jeopardy. The new director general, Mr. Renato Ruggiero, who must be congratulated for having made the right move earlier in rejecting the call for a TAFTA (Transatlantic Free Trade Area) in favour of concentrating on multilateralism at the WTO, cannot but have noticed, though he refrained from saying so, that the U.S. handling of the car dispute with the instrumentality of aggressive unilateralism was incompatible with the spirit, if not the letter, of multilateralism. For his part, Sir Leon Brittan did unhesitatingly voice his own and the EU's forthright and unambiguous condemnation of the U.S. action.

(3) The U.S. action also damaged the world trading system by using the threat of punitive tariffs against Japanese car firms in the attempt to get them to capitulate to its demands. As I observed above, this pitted a government with huge political and economic resources against foreign companies subject to stringent budget constraints. This introduces an extraordinary new source of instability and unpredictability into world trade: when multinationals are present in many countries under the conditions of increased globalization of investment and production, the use of such intimidation exposes all to potential threats of disrupted markets and "takings" by blackmail.¹⁶

(4) It is worth recalling also that a policy of demanding VIEs, no matter what euphemisms are used, is also damaging to the world trading system since it is a sure-fire way of creating trade diversion: Japanese firms forced by the United States to accept VIEs could be counted upon to satisfy them by diverting market-determined orders away from others to U.S. exporters.¹⁷ This is precisely why the Europeans were up in arms against any deal along these lines between Japan and the United States. It is also the reason why Australia (one of whose components firms had just lost its traditional sales to a Japanese car manufacturer who said that he had no choice but to shift to an inferior U.S. supplier because of the political pressure) wanted to join the EU in sitting at the table if there were going to be new talks between the United States and Japan on the car dispute.¹⁸

(5) Of course, VIEs are no less than "managed trade," despite the administration's expressions of outrage when this is stated. By now, the downside of such import targets is well understood by economists. I would reiterate in particular that these targets amount to "export protectionism": conventional import protectionism assures your firms a guaranteed increase in the domestic market, whereas VIEs assure such an increase in the export market.

Damage to the Clinton Administration

(6) It is clear enough that this action by the USTR has done serious international damage to the reputation of the Clinton administration in relation to the credibility of its commitment to multilateralism, given the demonstration of its continued attachment to a policy of aggressive unilateralism. This is fine when the United States is exercising moral leadership on an issue and is widely perceived to be doing so. It is not fine when the United States is seen universally as failing in probity and good sense simply in pursuit of short-run advantage for itself.

(7) That the administration allowed itself to be so badly outwitted by Japan in the dispute also bears witness to the inaptitude of the Clinton advisers.

The Future of U.S.-Japan Trade Relations

Even as this episode has closed, the Clinton administration must confront the question, What profit does the United States derive by conducting its trade relations with Japan in this way? These bilateral negotiations tied down to a one-way stream of demands, in which the United States casts itself simultaneously as complainant, jury, and judge, constantly yelling at the Japanese, seeking concessions, and offering none, contain absolutely no element of the reciprocity and symmetry that define virtually all other successful negotiations among trading nations. It is an approach whose days are numbered. Indeed MITI's forceful rejection of the proposed illegal actions and of unreasonable, one-way demands on its car firms, and its clear message to the United States that "we will see you in court," is exactly what the U.S. response would be if another nation were to attempt to push it around. Just imagine what would happen if the French government were to zero in and blackmail IBM or Xerox the way Mr. Kantor went after the Japanese car firms: Congressmen would be calling for French blood.

As soon as the present dust has settled, the Japanese can be expected to tear up the 1993 Framework Agreement between the two countries. If either nation has specific complaints, and indeed Japan has problems with the United States too (see the Matsushita Report on others' unfair trade practices), resolution must be sought bilaterally. If this does not work, recourse to the WTO for impartial resolution of the conflict must be made.

Proceeding with Japan as if it were an outlier and an outlaw is not merely unjustified by the facts; it is also a politically futile

policy, doomed (thank heavens) to failure. In short, the chief lesson of the car dispute and its resolution for U.S. trade policy toward Japan is that trade relations with Japan need to be normalized.

Notes

1. See, in particular, the two essays in Bhagwati and Krueger (1995). See also Bhagwati and Panagariya (1996, esp. chap. 1), which effectively challenges the popular notion that PTAs among countries with high initial volumes of trade or which are geographically proximate are somehow "natural" and most unlikely to cause harm despite their being preferential. These contributions make a strong case that the Clinton administration's continuing embrace of PTAs is a folly.

2. The book, while successful in political circles, where it played to popular prejudice, and in the electronics industry where it served their lobbying interests, received more critical notice in the professional journals. I also reviewed it in Bhagwati (1993).

3. It is often argued that the "new" trade theory, based on imperfect competition in product markets, hurt free trade policy by strengthening the case for protection. There is some evidence that it may have, especially in the way Krugman et al. were cited by Kuttner et al. in support of their demands for protection. However, this was true only of economic illiterates who were unaware that the case for free trade depends on market prices reflecting social costs and that market failures can compromise that case (though, as I and others noted in the postwar contributions to the theory of commercial policy, trade interventions are not always the first-best way to fix these market failures): see, in particular, the historical analysis in my 1993 Harry Johnson Lecture to the Royal Economic Society: Bhagwati (1994a).

The real damage that Krugman et al. did to the trading system in the 1980s was rather by reviving the old argument that import protection could lead to export promotion, so that if my market was open and yours was not, then I could get hurt and you could benefit: precisely the zero-sum proposition that many chief executives in international industries and the Japan-baiters latched on to! This argument led to the excessive preoccupation with reciprocity and the insistence on the folly of MFN, which the United States currently exhibits just when unilateral opening of markets and deregulation are beginning to be seen as great engines for competitiveness and the insistence on reciprocity of openness makes little sense! On this issue, see Bhagwati (1995a).

4. These and other problems with VIEs I have noted in several writings. The best single current source, however, is Irwin (1994).

5. It can fairly be said that the editorial comments in important newspapers and magazines, such as the *Financial Times*, the *Wall Street Journal*, the *Economist*, the *New Republic*, among numerous others, were unusually scathing, and that the action taken was sufficiently momentous in its import for the world trading system to make many economists wonder whether this was not an occasion when the leading economists in this administration should have resigned in protest. A letter to the president, asking him to withdraw the tariff threat and to use the WTO dispute settlement process instead, was also signed by nearly 100 prominent U.S. economists.

6. See, in this context, my critical review of Laura Tyson's book, *Who's Bashing Whom? Trade Conflict in High-Technology Industries* Bhagwati (1993), (Washington, D.C.: Institute for International Economics, 1992), and Bhagwati (1994b).

7. He fell victim to the Whitewater investigation, having come uncomfortably close to perjury in his testimony before Congress and lost his viability in the administration in consequence. His piece in *Foreign Affairs* (Altman 1994), paired with mine (Bhagwati 1994b), is a defence of the Clinton administration's Japan policy that I can safely leave the reader to assess without assistance and confidently expect her to dismiss without reservation.

8. Interestingly, the Japan-baiters and Japan-worriers of yesteryear were the so-called revisionists: Chalmers Johnson (a scholar), Clyde Prestowitz, James Fallows, and Pat Choate (subsequently Ross Perot's in-house economist). They seem to have been replaced in prominence by John Judis (*New Republic*), Michael Lind (a journalist), Thomas Friedman, and Pat Buchanan.

9. It is noteworthy that tariff retaliations prompted by Section 301 have previously always been designed so as to make them legal under the GATT. This time, the USTR deliberately chose clearly GATT-illegal retaliation, not because it enjoys violating the rule of law (though it is disturbing that most trade economists and lawyers are convinced that Mr. Kantor has no respect for the rule of law, having frequently asserted that all that he cares about are "results," and having now demonstrated clearly that he means what he says), but because the strategy of getting the Japanese car firms to capitulate meant that the bound tariffs on their exports had to be raised illegally, as I explain in the text.

10. This is but one of the several aspects of the USTR's defiance of the spirit, even at times the letter, of the rules agreed to at the Uruguay Round that made the U.S. policy in the car dispute a cause of distress among those who are wedded to multilateralism and the rule of law.

11. In this context, it is interesting to contrast the USTR's annual report on unfair trade practices with that issued by MITI. The former, as I remarked earlier in the text, is a list of self-serving complaints by lobbies. The latter, by contrast, is written by a team led by Professor Matsushita, Japan's leading expert on GATT law and an internationally respected scholar now on the Appellate Board at

the WTO, who focuses on unfair trade as defined by a strict criterion—the WTO-inconsistency of other nations' trade policies. Besides, the MITI report includes at the end the EU and the USTR reports on Japan's unfair trade policies! You would think that the United States, a transparent and fair-minded nation, would be publishing a MITI-type report whereas Japan, which is nontransparent and unfair according to the ceaseless U.S. complaints, would be issuing the USTR type of report!

12. Since several European car manufacturers have already made the necessary investment in their own dealerships, this also added to the EU objections (discussed below) to the U.S. demands. In particular, they regarded it as unacceptable that the Detroit car manufacturers be given less expensive entry into Japan by forcing the Japanese car firms to open their own distribution networks to the U.S. firms. That would mean that the EU firms would have been treated disadvantageously vis-à-vis their U.S. rivals.

13. The work of economist Robert Lawrence, which suggests that Japanese vertical *keiretsu* are exclusionary, has been questioned by Gary Saxonhouse; besides, it does not compare the effects of U.S. vertical integration with those of a *keiretsu* structure.

14. This is the effective answer to the much-cited remark by a Toyota-U.S. spokesman that the Toyota transplants would like to buy more parts made in the United States but were buying them from Japanese suppliers to maintain employment in Japan. That may well be true now; but if so, this would cut into Toyota's profits quickly by hitting the firm's costs in a highly competitive and contestable global industry and in that case Toyota would soon abandon such an altruistic policy. The reality, as distinct from the spokesman's concern for his compatriots' employment, may well be that Toyota may be expecting the high yen to fall soon, which would explain the desire not to disrupt existing and efficient supply relationships for short-run advantage.

15. Quoted by Latham (1995), who offers a strong critique of this claim, arguing its essential historical inaccuracy. Even if one does not accept Latham's critique fully, it persuades one that, at minimum, the claim is misleadingly simplistic.

16. See the critique of the U.S. action by Douglas Irwin, the noted analyst and critic of VIEs, in Irwin (1995) and my earlier op-ed on the same point in the *Journal of Commerce*.

17. I had noted this problem in Bhagwati (1990).

18. Despite the public relations rhetoric that the United States wants imports into Japan to go up regardless of whose exports increase, there is no doubt whatsoever that the USTR wants its own lobbies to benefit from the highhanded 301 tactics and that the Japanese understand this.

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